ECONOMIC OUTLOOK
AND
REVENUE ESTIMATES
FOR MICHIGAN

FISCAL YEARS
2002-03 AND 2003-04

HOUSE FI$CAL AGENCY

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FOREWORD

The House Fiscal Agency (HFA) is pleased to present this report to members of the Michigan House of Representatives. The purpose of the report is to inform members of the final General Fund/General Purpose and School Aid Fund revenue estimates for fiscal year (FY) 2001-02, the revised revenue estimates for FY 2002-03, and the initial revenue estimates for FY 2003-04. The estimates reported herein will be presented to the Consensus Revenue Estimating Conference on January 14, 2003, and will be used to facilitate the consensus estimating process.

This report includes HFA analyses of important factors that will affect state and national economies through the year 2004, estimates of the Countercyclical Budget Stabilization Fund, state compliance with the Constitutional State Revenue Limit, and year-end balance estimates for the General Fund/General Purpose and the School Aid Fund.

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EXECUTIVE SUMMARY

Following the recession in FY 2000-01, economic growth was weak at both the national and state levels throughout FY 2001-02. Based on final FY 2001-02 figures, baseline General Fund/General Purpose (GF/GP) revenues declined 4.5%, while School Aid Fund (SAF) revenues grew 1.3%. Baseline figures are used to evaluate growth due to underlying economic factors and they do not include the effects of tax policy changes.

The House Fiscal Agency (HFA) expects the current recovery to remain weak in the first two quarters of FY 2002-03. Economic activity, however, is expected to accelerate during the second half of FY 2002-03. Economic growth is forecast to remain at a healthy level throughout FY 2003-04. Important aspects of the HFA forecast are summarized as follows.

U. S. Forecast

Real GDP growth will pick up to 2.6% in CY 2003 from the 2.4% pace posted in CY 2002. Real GDP is forecast to grow 4.0% in CY 2004.

Inflation, as measured by the Consumer Price Index (CPI), will increase from 1.6% in CY 2002 to 2.6% in CY 2003, then accelerate to 2.8% in CY 2004.

Light vehicle sales totaled 16.5 million units in CY 2002 and are forecast to remain at 16.5 million units in CY 2003, then increase to 16.6 million units in CY 2004. The import share of light vehicles is forecast to be 19.9% in CY 2003, up from 19.8% in CY 2002. The import share is then forecast to decline by 19.1% in CY 2004.

The *national unemployment rate*, which was estimated to be 5.8% in CY 2002, is forecast to increase to 6.0% in CY 2003, then fall to 5.5% in CY 2004. The unemployment rate is expected to peak at 6.2% in the first quarter of CY 2003.

Interest rates on three-month T-bills averaged 1.6% in CY 2002 and are forecast to remain at 1.6% in CY 2003 before increasing to 3.3% in CY 2004.

Michigan Forecast

Michigan personal income increased by 2.0% in CY 2002. The rate of growth will increase to 3.8% in CY 2003 and then pick up to 5.4% in CY 2004.

Michigan unemployment rate was 6.1% in CY 2002. It is forecast to decrease to 5.9% in CY 2003 and decline to 5.3% in CY 2004. Similar to the U.S. forecast for unemployment, Michigan's unemployment rate is expected to peak at 6.1% in the first quarter of CY 2003.

Inflation, as measured by the Detroit Consumer Price Index, was 2.6% in CY 2002, is forecast to increase to 2.7% in CY 2003, and increase to 2.8% in CY 2004.

U ***State Revenues***

Total baseline GF/GP and SAF revenues were $18.4 billion in FY 2001-02, and are forecast to increase 1.9% to $18.7 billion in FY 2002-03 and 4.6% to $19.6 billion in FY 2003-04. Baseline revenues do not include prior-year fund balances or reflect the effects of recent tax policy changes.

Total actual GF/GP and SAF revenues were $18.6 billion in FY 2001-02 and are forecast to increase $577.5 million or 3.1% to $19.1 billion in FY 2002-03, then increase $182.9 million or 1.0% to $19.3 billion in FY 2003-04. Actual revenues are resources available and include the impact of tax changes.

U ***State Revenue Limit***

Total state revenues are expected to be below the state revenue limit by $3.98 billion in FY 2001-02, under the limit by $4.06 billion in FY 2002-03, and under the limit by $4.28 billion in FY 2003-04.

Final calculation of the state revenue limit is performed by the Auditor General.

U ***Year-End Fund Balances***

The *year-end GF/GP balance* was $114.5 million in FY 2001-02. The year-end balance for FY 2002-03 is expected to be zero.

The *School Aid Fund year-end balance* was $237.0 million in FY 2001-02. The year-end balance for FY 2002-03 is expected to be zero.

The *Countercyclical Budget Stabilization Fund year-end balance* was $145.2 million in FY 2001-02 and zero balance is forecast for both FY 2002-03 and FY 2003-04.

U ***Baseline and Actual Revenue Estimates***

Table 1 reports GF/GP and SAF revenues in terms of baseline and actual revenues.

Baseline revenues do not include the impact of partial-year policy changes or certain policy changes that have only recently occurred. *Baseline estimates* are comparable across fiscal years and demonstrate the changes to state revenues that are driven by changes in the economy.

Actual GF/GP revenues capture the effects of all policy changes and represent resources actually available. *Actual SAF revenues* do not include beginning fund balances or transfers from the BSF or GF/GP.

Table 1

HFA REVENUE ESTIMATES (Millions of Dollars)

	Final FY 2001-02	FY 2002-03	FY 2003-04
BASELINE			
GF/GP	$8,263.3	$8,345.3	$8,769.2
SAF	10,101.4	10,376.1	10,816.6
TOTAL	**$18,364.7**	**$18,721.4**	**$19,585.7**
ACTUAL			
GF/GP	$8,425.0	$8,176.1	$8,356.6
SAF	10,133.9	10,960.4	10,962.6
TOTAL	**$18,558.9**	**$19,136.4**	**$19,319.3**

NOTE: Numbers may not add due to rounding.

ECONOMIC REVIEW AND FORECAST

This section presents the economic forecast used by the House Fiscal Agency to produce its updated revenue forecast for FY 2002-03 and initial revenue forecast for FY 2003-04.

The longest U.S. economic expansion on record ended in March 2001 as the economy slid into a recession. Although the recession was modest, economic growth has remained weak and unstable throughout CY 2002. It is forecast that real GDP will grow by 2.4% in CY 2002 and 2.6% in CY 2003. Economic growth is then expected to accelerate at a 4.0% rate in CY 2004.

Figure 1 shows the Institute of Supply Management (ISM) Index dating back to January 1999. An index number above 50 indicates a growing manufacturing sector, while a number below 50 suggests that the manufacturing sector is contracting. The index reached a peak in December 1999, and then began a downward trend. It fell below 50 in August 2000, and remained below 50 until February 2002. After peaking in June 2002, the index began to drop again. By September, the index had fallen below 50, where it remained for three months before jumping to 54.7 in December.

A very similar story is portrayed in **Figure 2**, which shows the University of Michigan Index of Consumer Sentiment. Consumer sentiment is a driving force behind personal consumption expenditures, which represent almost two-thirds of GDP. Thus, even though the ISM index began to fall in early 2000, consumers remained cautiously optimistic about the economy.

Although the consumer sentiment index remained at historically high levels throughout most of CY 2000, it nosedived in December 2000 and continued falling until February 2001. Like the ISM index, consumer sentiment rebounded somewhat through August 2001 before plunging again in September 2001. It is important to note that most of the surveys that comprise each month's index had already been completed prior to the September 11 attacks.

Following the September 2001 low, consumer sentiment generally increased for the next eight months before reaching a peak in May 2002. Concern about the state of the economy caused the index to drop for next five months, hitting a ten-year low in October 2002.

Figure 1

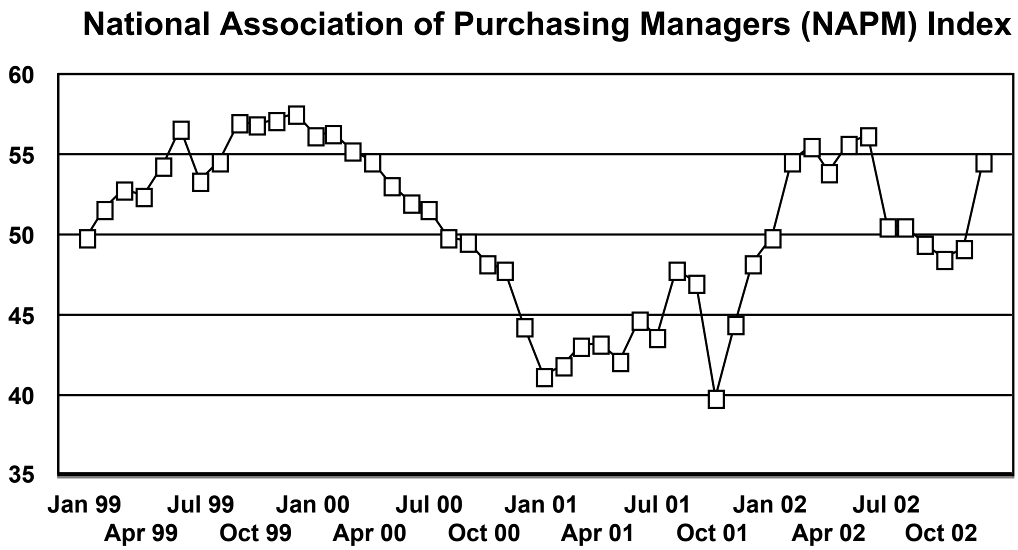
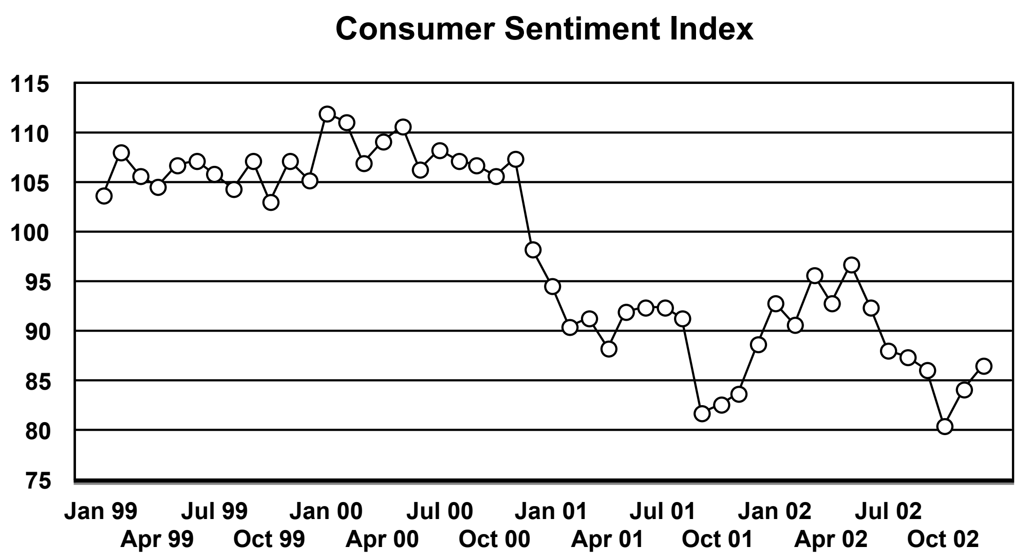


Figure 2



Like the ISM index, consumer sentiment has risen slightly the past two months. While not enough to establish a trend, these are hopeful signs that the economic recovery will strengthen in the near future.

U ***Real GDP***

After rising by 4.0% during the third quarter of 2002, real GDP is expected to grow by only 0.1% in the fourth quarter. Although it appears as if the recession ended during the fourth quarter of CY 2001, growth thus far in CY 2002 has been uneven and is expected to total about 2.4% for the full year after growing by 0.3% in CY 2001.

Real GDP growth in CY 2003 is forecast to be 2.6% before increasing by 4.0% in CY 2004.

The GDP component showing the most significant improvement in CY 2002 is private investment. After falling at a 10.7% rate during CY 2001, gross private domestic investment is estimated to rise by 0.5% in CY 2002, 4.6% in CY 2003, and 9.0% in CY 2004. Much of the expected growth can be attributed to increased expenditures on information processing equipment and inventory rebuilding.

Personal consumption, which accounts for almost two-thirds of real GDP, advanced at a 2.5% rate during CY 2001. This rate is estimated to grow by 3.0% in CY 2002 before tapering off to 2.4% in CY 2003. As the economy picks up, personal consumption is predicted to increase by 3.5% in CY 2004.

U *Interest Rates*

The discount rate began CY 2002 at 1.25% before a 50 basis point cut in early November dropped it to an all time low of 0.75%. Throughout the forecast horizon, key interest rates are forecast to remain relatively low, although they should begin to rise during the second half of CY 2003.

The *federal funds rate* is expected to average 1.7% in both CY 2002 and CY 2003 before rising to 3.5% in CY 2004.

The *three-month Treasury bill rate* is predicted to average 1.6% in both CY 2002 and CY 2003 before increasing to 3.0% in CY 2004.

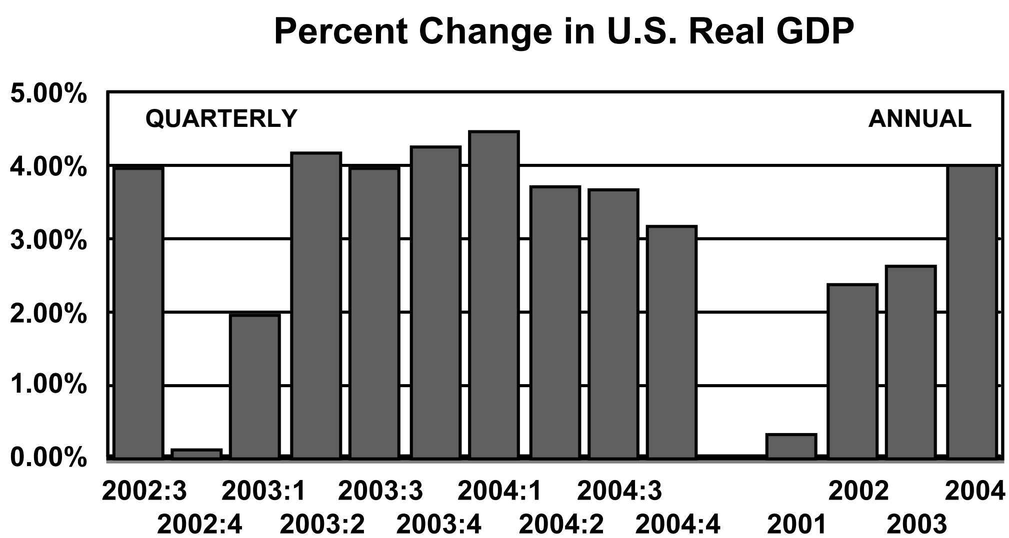
The *30-year conventional mortgage rate* is forecast to average 6.6% in CY 2002, 6.2% in CY 2003, and 6.4% in CY 2004.

U *Housing Market*

Preliminary data indicate that sales of new and existing single family dwellings in CY 2002 will exceed the CY 2001 total of 5.9 million units by more than 150,000. This increase has been fueled by a decline in mortgage rates due to historically low interest rates.

Housing starts, which include both single and multi-family units, are expected to total 1.68 million in 2002 before dropping to 1.60 million in CY 2003 and 1.57 million in CY 2004.

Figure 3



U ***Light Vehicle Sales***

The generous rebates and special financing offers that began in the latter half of CY 2001 continued well into CY 2002. Despite incentives, sales of light motor vehicles in CY 2002 totaled 16.5 million units, well below CY 2002's record level of 17.2 million units. *Light vehicle sales* are anticipated to total 16.5 million units in CY 2003 and 16.6 million units in CY 2004.

Over the past several years there has been a shift in sales away from cars and toward light trucks. This trend is expected stabilize, and the share of light trucks is expected to remain roughly constant throughout the forecast period. *Light trucks* are expected to account for 51.4% percent of total sales in CY 2002, and 51.3% in both CY 2003 and CY 2004.

The *import share of total light vehicle sales* rose to 18.1% in CY 2001. The import share is forecast to increase to 19.8% in CY 2002 and 19.9% in CY 2003 before declining slightly to 19.1% in CY 2004.

U ***Inflation: U.S.***

The overall increase in input prices (such as energy prices, wages, and import prices) has generally remained moderate, and has helped to hold down production costs. Inflation is expected to remain low, by historical standards, through the forecast period.

In sharp contrast to CY 2001, crude oil prices have jumped significantly over the past year. The price of benchmark West Texas intermediate crude, which began the year near $20 per barrel, has risen steadily to more than $30 per barrel in December 2002. After peaking at $28 per barrel in the first quarter of CY 2003, it is anticipated that oil prices will remain near $25 per barrel during CY 2003 and CY 2004.

The factors noted are expected to lead to an average annual increase in the *U.S. Consumer Price Index-Urban* (CPI-U) of 1.6% in CY 2002, 2.6% in CY 2003, and 2.8% in CY 2004.

U ***Inflation: Michigan***

The cost of living in Michigan, is measured by the *Detroit Consumer Price Index for Urban Consumers* (Detroit CPI-U). Preliminary data suggest an increase of 2.6% in CY 2002. Inflation in Michigan is forecast to increase by 2.7% in CY 2003 and 2.8% in CY 2004.

Figure 4

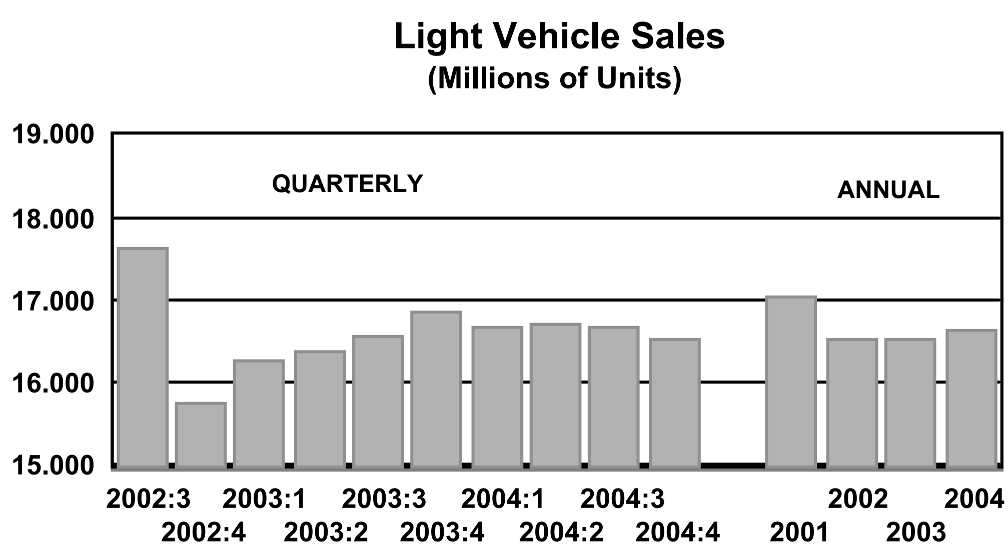


Figure 5

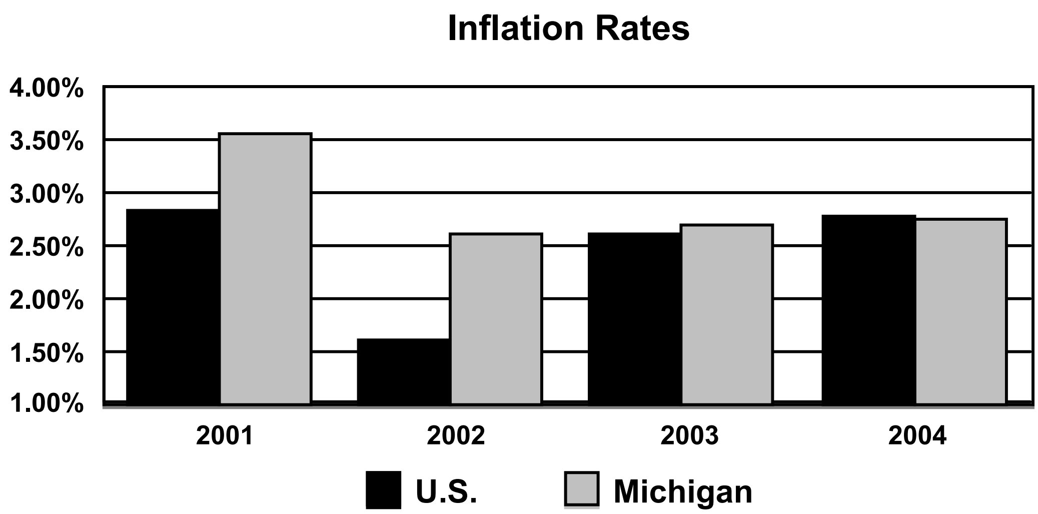
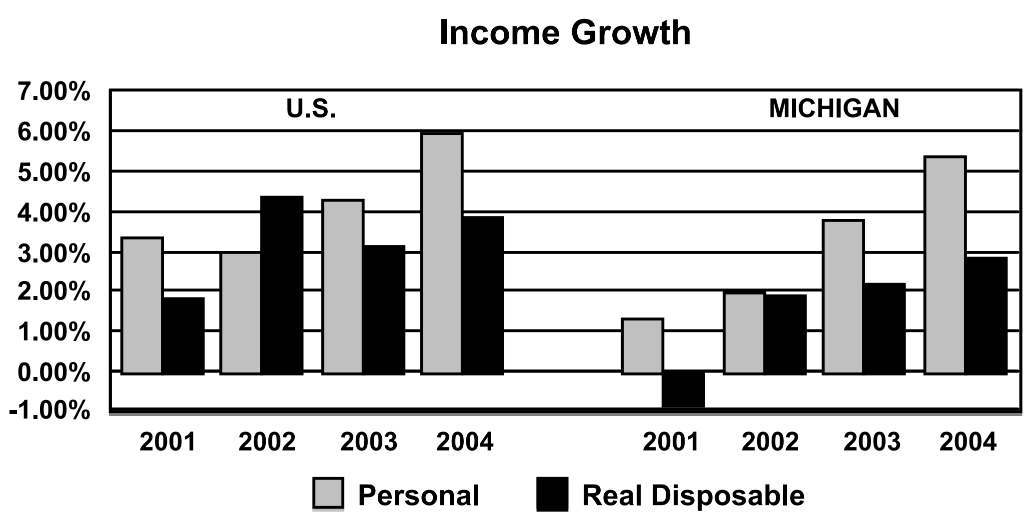


Figure 6



U *Income Growth: U.S.*

Total *U.S. personal income* is estimated to grow by 3.0% in CY 2002. Personal income growth is forecast to increase by 4.3% in CY 2003 and 6.0% in CY 2004.

Moderate growth in inflation will contribute to an anticipated 4.3% rate of growth of *U.S. real disposable income* in CY 2002. It is forecast that U.S. real disposable income growth will dip to 3.1% in CY 2003 before climbing to 3.9% in CY 2004.

U *Income Growth: Michigan*

In contrast to the U.S., Michigan's total *state personal income* growth is estimated at only 2.0% in CY 2002. It is forecast that Michigan personal income will increase by 3.8% in CY 2003 and by 5.4% in CY 2004.

Michigan real disposable income is estimated to grow 1.9% in CY 2002—much better than the 0.8% drop posted in CY 2001. In CY 2003, real disposable income is forecast to grow by 2.2% before picking up to 2.8% in CY 2004.

Figure 7

Wage and Salary Employment Growth
Indexed to 2000:1 for U.S. and Michigan

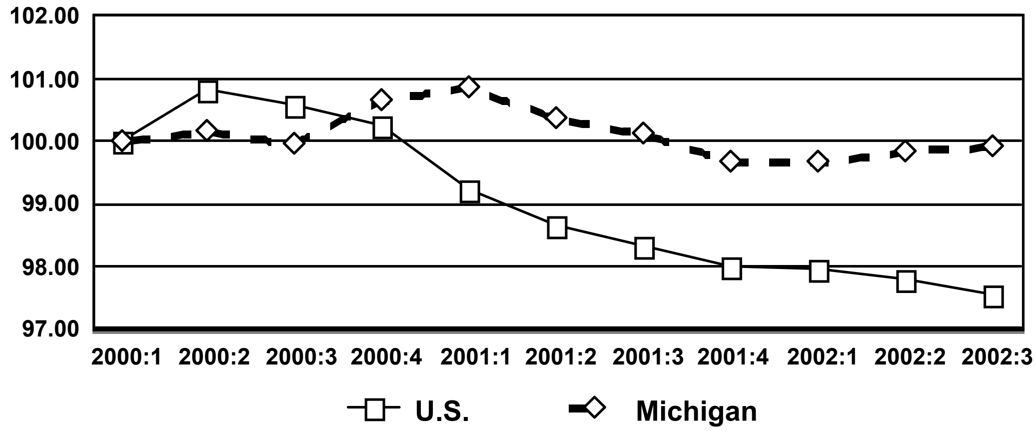


Figure 8

Michigan Employment Growth

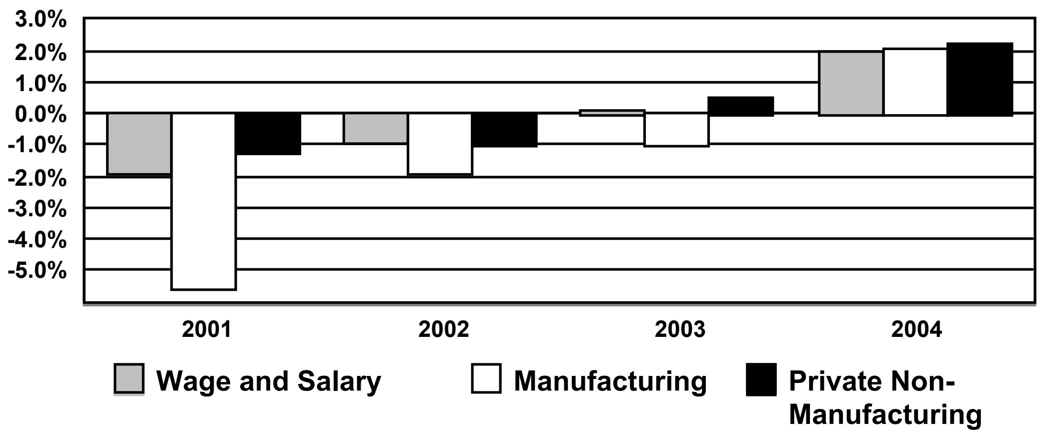
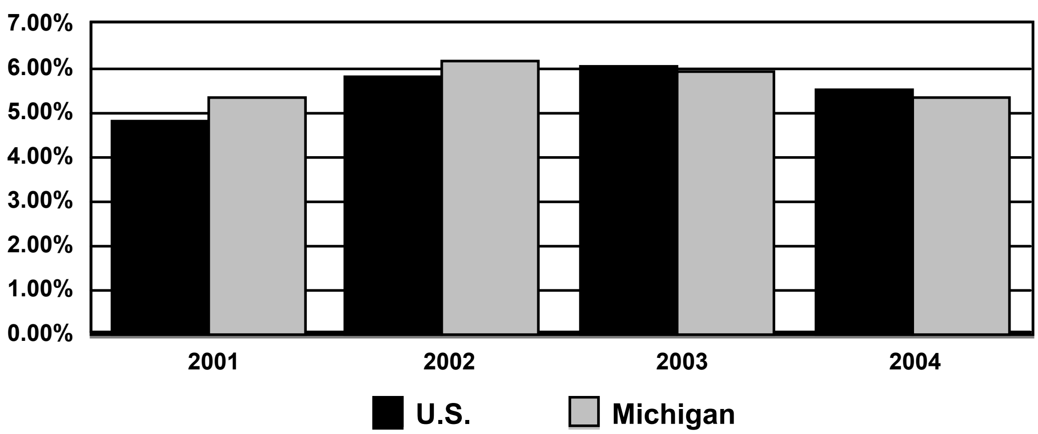


Figure 9

Unemployment Rates



U *Employment: U.S.*
One critical reason underscoring the difference in income growth between the U.S. and Michigan is overall job growth. When indexed to the first quarter of 2000, wage and salary employment in the U.S. increased slightly before tapering off in the fourth quarter of 2001.

U *Employment: Michigan*
The Michigan economy endured a weak labor market throughout CY 2001. Wage and salary employment dropped by 1.9%; private nonmanufacturing employment fell by 1.2% while manufacturing employment declined by 5.6%.

Michigan wage and salary employment is forecast to fall by 0.9% in CY 2002 before growing by 0.1% in CY 2003 and 2.0% in CY 2004.

Michigan manufacturing employment is forecast to drop by 1.9% in CY 2002 and 1.0% in CY 2003 before rebounding at a 2.0% rate in CY 2004. Although the most significant declines are concentrated in the motor vehicle industry, employment declines are also spread throughout the manufacturing sector.

Michigan private nonmanufacturing employment is expected to decline by 1.0% in CY 2002, before growing by 0.5% in CY 2003 and 2.3% in CY 2004.

U *Unemployment: U.S.*
Non-farm payroll employment increased slightly in CY 2002, but was unable to keep pace with the growth of the labor force, resulting in an increase in the unemployment rate.

The *U.S. unemployment rate* is estimated to be 5.8% in CY 2002, and is forecast to increase to 6.0% in CY 2003 before decreasing to 5.5% in CY 2004.

U *Unemployment: Michigan*
As in the U.S., unemployment in Michigan is becoming a concern as job growth has fallen during CY 2002.

Michigan's unemployment rate is predicted to be 6.1% in CY 2002. The unemployment rate is forecast to drop to 5.9% in CY 2003 and 5.3% in CY 2004.

Table 2

ECONOMIC VARIABLES

U.S. Forecast

Variable	CY 2001	CY 2002	CY 2003	CY 2004
Real GDP Growth	0.3%	2.4%	2.6%	4.0%
Rate of Interest, 3-Month Treasury Bill	3.4%	1.6%	2.6%	3.0%
Rate of Interest, 30-Year Conventional Mortgage	7.0%	6.6%	6.2%	6.4%
Housing Starts (thousands of units)	1,602.8	1,682.1	1,604.6	1,572.3
Light Vehicle Sales (millions of units)	17.0	16.5	16.5	16.6
Automobiles	8.4	8.0	8.0	8.1
Light Trucks	8.6	8.5	8.5	8.5
Import Share of Light Vehicle Sales	18.1%	19.8%	19.9%	19.1%
U.S. CPI-U—Percentage Change	2.9%	1.6%	2.6%	2.8%
U.S. Personal Income Growth	3.3%	3.0%	4.3%	6.0%
Unemployment Rate	4.8%	5.8%	6.0%	5.5%

Michigan Forecast

Variable	CY 2001	CY 2002	CY 2003	CY 2004
Detroit CPI-U—Percentage Change	2.7%	2.6%	2.7%	2.8%
Michigan Personal Income Growth	1.3%	2.0%	3.8%	5.4%
Michigan Wage and Salary Income Growth	-1.3%	0.2%	3.7%	5.0%
Unemployment Rate	5.3%	6.1%	5.9%	5.3%
Wage and Salary Employment Growth	-1.9%	-0.9%	0.1%	2.0%
Manufacturing Employment Growth	-5.6%	-1.9%	-1.0%	2.0%
Services Employment Growth	-1.2%	-0.6%	1.2%	2.8%
Wholesale & Retail Trade Employment Growth	-1.7%	-1.8%	-0.4%	2.1%

RISKS AND UNCERTAINTIES

An economic forecast is based on the best information available at the time the forecast is made. Because information and foresight are not perfect, there are always risks and uncertainties built into a forecast. The key risks in this forecast stem predominantly from uncertainties surrounding geopolitical tensions; specifically, the potential of war with Iraq or other major terrorists attacks on U.S. interests. Key risks are discussed as they pertain to business fixed investment, consumer behavior, and monetary and fiscal policy.

Business Fixed Investment

Business fixed investment remains a significant risk in the forecast. Over the last several months, uncertainty about the underlying strength of the economy in conjunction with the potential of war with Iraq have dampened business confidence and put off increases in investment and hiring. However, corporate profits during the third quarter of 2002 posted a 12.2% increase from the year-ago quarter.

An improving profit outlook, plus the need to invest to stay competitive, will lead to growth in nonresidential business fixed investment. Nonresidential business fixed investment is forecast to increase 4.7% in CY 2003 and 8.8% in CY 2004.

The business component of the economy is volatile, and steep declines are typically followed by sharp increases. Business fixed investment could come back sooner than anticipated in this forecast, which would effect the speed and degree of the recovery. On the other hand, if a war with Iraq commences and the outlook is uncertain, business fixed investment would be below the forecast level.

Consumer Behavior

Consumer behavior, to a significant degree, determines overall economic growth. Following a 4.1% gain in the third quarter of 2002, much of which was due to motor vehicle sales, consumption is likely to decline in the fourth quarter of 2002. This pattern is predominantly the result of weak holiday purchases during the fourth quarter of 2002 and a shift of motor vehicle sales from the fourth quarter of 2002 to the third quarter of 2002—due to heavy discounts. For CY 2003, personal consumption is forecast to grow 2.4% followed by a 3.5% pace in CY 2004.

Consumer behavior is driven by consumer confidence, employment, and income. Consumer sentiment has edged slightly higher in the last two months. An improvement in employment has not yet occurred, and the forecast assumes that employment will not begin to grow until the second quarter of 2003 as businesses hold off hiring until growth picks up and stabilizes. Hence, if the pace of employment and income picks up more quickly than forecast, consumption and the overall economy will be stronger than estimated.

Another significant component of personal consumption and key to Michigan's economy is the level and composition of light motor vehicle sales. Light vehicle sales were 16.5 million units in CY 2002 and are forecast to be 16.5 million in CY 2003 and 16.6 million in CY 2004. The import share of light vehicles was 19.8% in CY 2002 and is forecast to increase slightly to 19.9% in CY 2003 then fall to 19.1% in CY 2004.

Motor vehicle sales have remained at relatively high levels despite the weakness in the overall economy primarily because of very low interest rates and very high incentive levels offered by the motor vehicle companies to gain market share. This forecast assumes favorable buying conditions will continue until the economy strengthens. If the incentives are reduced too soon, then the level of light motor vehicle sales would be lower than the forecast.

Monetary Policy

After eleven rate cuts in 2001 and an additional 50 basis point reduction in November 2002 by the Federal Reserve (Fed), the discount rate has reached 0.75%—the lowest in over 40 years. The federal funds rate has been reduced to 1.25%. Included in this forecase are increases in both the discount rate and the federal funds rate during the third quarter of 2003, as the economy starts to expand at a healthier pace.

Fiscal Policy

Built into the forecast is an expansionary federal fiscal policy, which consists of emergency spending, the fiscal stimulus package, and the tax act of 2001. Not built into the forecast is a new round of tax cuts that were announced by the Bush administration on January 7, 2003. The effect a new round of tax cuts would have on the economy depends on the size, timing, and form of the tax cut. Federal government spending is estimated to increase 5.6% in CY 2003 and 4.9% in CY 2004. Fiscal policy, particularly defense spending, may increase at a faster rate than estimated if a was with Iraq starts—which would push up overall economic growth at the U.S. level.

Counter to the federal fiscal policy, state and local government spending is expected to decline by 0.8% in CY 2003 and remain flat in CY 2004. According to the National Conference of State Legislatures (NSCL), for this fiscal year, the states have a $17.5 billion deficit, which is 3.6% of total spending. Since most state and local governments have balanced budget requirements, the budget shortfalls must be dealt with by increasing revenues or reducing spending.

GF/GP AND SAF REVENUES

Revenue estimates are based on the economic performance of national and state key variables. This section explains January 2003 House Fiscal Agency revenue estimates for GF/GP and School Aid Fund revenue by major revenue sources. It provides revenue estimates, year-end balances for the major funds and the budget stabilization fund, and the state revenue limit calculation.

GF/GP Revenue by Source

Personal Income Tax

After declining 0.6% in FY 2001-02, wage and salary income is expected to post a 3.3% gain in FY 2002-03 and then pick up to 4.8% in FY 2003-04. This will lead to faster growth, relative to FY 2002-03, in Michigan personal income and income tax revenues in FY 2003-04.

Baseline *GF/GP income tax revenues* decreased 8.7% to $4,229.8 million in FY 2001-02. Baseline GF/GP income tax revenue is forecast to remain flat in FY 2002-03 and increase 5.4% to $4,469.5 million in FY 2003-04. Baseline revenues do not include the impact of decreasing the income tax rate to 4.0% in CY 2003 and 3.9% in CY 2004.

Sales and Use Taxes

Continued growth in disposable income (which is forecast to increase 5.1% in FY 2002-03 and 5.7% in FY 2003-04) is expected to increase sales and use tax revenue. *Baseline sales and use tax revenue* totaled $949.5 million in FY 2001-02, and is forecast to grow to $999.7 million in FY 2002-03 and $1,059.3 million or 6.0% in FY 2003-04.

Single Business and Insurance Taxes

All Single Business Tax (SBT) revenues accrue to GF/GP. Baseline business taxes (SBT plus insurance taxes) totaled $2,168.9 million in FY 2001-02. *Baseline business tax revenues* are forecast to increase 5.4% to $2,287.0 million in FY 2002-03 and 5.8% to $2,420.7 million in FY 2003-04.

Baseline SBT revenues alone totaled $1,941.8 million in FY 2001-02; they are forecast to increase 5.3% to $2,045.0 million in FY 2002-03 and 6.0% to $2,167.7 million in FY 2003-04. Baseline estimates do not include the full impact of the SBT rate changes, which will affect revenue collections.

U *GF/GP Baseline Tax Revenues*

Baseline GF/GP tax revenue totaled $7,933.8 million in FY 2001-02. *General Fund/General Purpose baseline tax revenues* are estimated to increase $188.3 million or 2.4% to $8,122.1 million in FY 2002-03 and $433.9 million or 5.3% to $8,556.0 million in FY 2003-04.

U *Total GF/GP Baseline Revenues*

Total baseline GF/GP revenues include baseline tax revenues and non-tax revenues. *Total GF/GP baseline revenues* were $8,263.3 million in FY 2001-02. General Fund/General Purpose baseline revenues are estimated to increase by 1.0% to $8,345.3 million in FY 2002-03 and 5.1% to $8,769.2 million in FY 2003-04.

U *Actual GF/GP Revenues*

Actual GF/GP revenues take tax changes into account and are available for expenditure each year. *Actual GF/GP revenues* totaled $8,425.0 million in FY 2001-02; they are forecast to decline by 3.0% or $248.9 million to $8,176.1 million in FY 2002-03 then increase 2.2% or $180.5 million to $8,356.6 million in FY 2003-04.

SAF Revenue by Source

U *Sales and Use Taxes*

Baseline SAF sales tax revenue increased 1.5% in FY 2001-02; it is forecast to grow 3.9% in FY 2002-03 and 5.0% in FY 2003-04. Baseline use tax revenue declined 2.3% in FY 2001-02; it is estimated to increase by 3.0% in FY 2002-03 and 5.0% in FY 2003-04. Combined *sales and use tax revenue* dedicated to the SAF equaled $5,127.5 million in FY 2001-02, it is forecast to increase 3.8% to $5,323.8 million in FY 2002-03 and 5.0% to $5,590.7 million in FY 2003-04.

U *Income Tax*

Approximately 25% of gross income tax revenue is dedicated to the School Aid Fund. Dedicated *income tax revenue* was $1,858.4 million in FY 2001-02; it is forecast to increase 0.5% to $1,868.5 million in FY 2002-03 and 5.0% to $1,962.6 million in FY 2003-04.

U *State Education Tax*

The 6-mill state education tax (SET) is dedicated to the SAF. Revenue from the SET totaled $1,583.8 million in FY 2001-02. *State Education Tax revenue* is forecast to increase 5.6% to $1,672.0 million in FY 2002-03 and 4.4% to $1,745.0 million in FY 2003-04.

U *Lottery Transfers and Casino Wagering Tax*

Lottery revenue contributed $613.5 million to the SAF in FY 2001-02. *Baseline Lottery revenue* to the SAF is projected to decline to $590.0 million in FY 2002-03 and remain flat in FY 2003-04. Casino/gaming tax revenue totaled $91.9 million in FY 2001-02, and is forecast to increase to $96.0 million in FY 2002-03, and $100.0 million in FY 2003-04.

U *Tobacco Taxes*

Approximately 64.0% of baseline gross tobacco tax revenue is dedicated to the School Aid Fund. In FY 2001-02, the School Aid Fund received $380.4 million from tobacco taxes. The demand for tobacco products is expected to decline slowly over the duration of the forecast. Total baseline *tobacco tax revenues* are expected to decrease to $371.7 million in FY 2002-03 and $364.6 million FY 2003-04. Baseline tobacco taxes do not include the fiscal impact of the tax increases.

U *Real Estate Transfer Tax*

Real estate transfer tax revenue, which is dedicated to the School Aid Fund, totaled $253.1 million in FY 2001-02. The real estate transfer tax is forecast to increase to $258.0 million in FY 2002-03 and $264.0 million in FY 2003-04.

U *Total SAF Baseline Revenues*

Total SAF baseline revenues were $10,101.4 million in FY 2001-02. *School Aid Fund baseline revenues* are forecast to increase $274.7 million or 2.7% to $10,376.1 million in FY 2002-03 and $440.5 million or 4.2% to $10,816.6 million in FY 2003-04.

U *Actual SAF Revenues*

Actual SAF revenues represent own-source revenues available for expenditure each year, excluding prior year-end balances, GF/GP transfers to SAF, and BSF transfers to the SAF. *Actual SAF revenues* totaled $10,133.9 million in FY 2001-02; revenues are forecast to increase $826.5 million or 8.2% to $10,960.4 million in FY 2002-03 and remain flat at $10,962.6 million in FY 2003-04.

Table 3

GF/GP REVENUE ESTIMATES (Millions of Dollars)

	Final			FY 2003-04 over 2002-03	
	FY 2001-02	FY 2002-03	FY 2003-04	% Change	$Change
Personal Income Taxes	$4,229.8	$4,240.4	$4,469.5	5.4%	$229.1
Sales and Use Taxes	949.5	999.7	1,059.3	6.0%	59.6
SBT and Insurance Taxes	2,168.9	2,287.0	2,420.7	5.8%	133.7
Other Taxes	585.6	595.0	606.5	1.9%	11.5
GF/GP Baseline Tax Revenues	**$7,933.8**	**$8,122.1**	**$8,556.0**	**5.3%**	**$433.9**
Non-Tax Revenue	329.5	223.2	213.2	-4.5%	(10.0)
Total GF/GP Baseline Revenues	**$8,263.3**	**$8,345.3**	**8,769.2**	**5.1%**	**$423.9**
Adjustments to Baseline	161.7	(169.3)	(412.5)	**143.7%**	**($243.2)**
Actual GF/GP Revenues	**$8,425.0**	**$8,176.1**	**$8,356.6**	**2.2%**	**$180.5**

NOTE: Numbers may not add due to rounding.

Table 4

SCHOOL AID FUND REVENUE ESTIMATES (Millions of Dollars)

	Final			FY 2003-04 over 2002-03	
	FY 2001-02	FY 2002-03	FY 2003-04	% Change	$ Change
Sales and Use Tax	$5,127.5	$5,323.8	$5,590.7	5.0%	266.9
Income Tax Earmark	1,858.4	1,868.5	1,962.6	5.0%	94.1
State Education Tax	1,583.8	1,672.0	1,745.0	4.4%	73.0
Lottery Transfers	613.5	590.0	590.0	0.0%	0.0
Tobacco Taxes	380.4	371.7	364.6	-1.9%	(7.1)
Real Estate Transfer Tax	253.1	258.0	264.0	2.3%	6.0
Other Taxes	284.7	292.0	299.7	2.6%	7.7
Baseline SAF Revenues	**$10,101.4**	**$10,376.1**	**$10,816.6**	**4.2%**	**$440.5**
Adjustments to Baseline	32.6	584.3	146.1	-75.0%	($438.2)
Actual SAF Revenues	**$10,133.9**	**$10,960.4**	**$10,962.6**	**0.0%**	**$2.2**

NOTE: Numbers may not add due to rounding.

Table 5

YEAR-END BALANCE ESTIMATES (Millions of Dollars)

	Final FY 1999-2000	Final FY 2000-01	Final FY 2001-02	Estimated FY 2002-03
General Fund/ General Purpose	$211.8	$28.0	$114.5	$0.0
School Aid Fund	$853.4	$694.8	$237.0	$0.0
Budget Stabilization Fund	$1,264.4	$994.1	$145.2	$0.0

HFA Estimates of Year-End Balances

Table 5 reports House Fiscal Agency estimates of year-end balances for GF/GP, the SAF, and the BSF. Final FY 1999-2000, 2000-01, and 2001-02 figures are included.

Budget Stabilization Fund estimates are based on current balance estimates provided by the Michigan Department of Treasury and HFA estimates of future deposits and interest earned.

School Aid Fund revenues are restricted; hence, any year-end balance is carried forward to the subsequent year.

BSF Year-End Balances

The Counter-Cyclical Budget and Economic Stabilization Fund (BSF), or the state's rainy day fund, is a reserve of cash to contribute to or withdraw from throughout the economic cycles. **Table 6** shows deposits, withdrawals, interest earnings, and the year-end balance from FY 1989-90 through FY 2001-2002. It also includes HFA estimates for FY 2002-03 and FY 2003-04. **Figure 9** depicts the BSF fund balance and fund balance as a percent of total GF/GP and SAF revenues from FY 1990-91 through FY 2003-04.

U ***FY 2001-02***

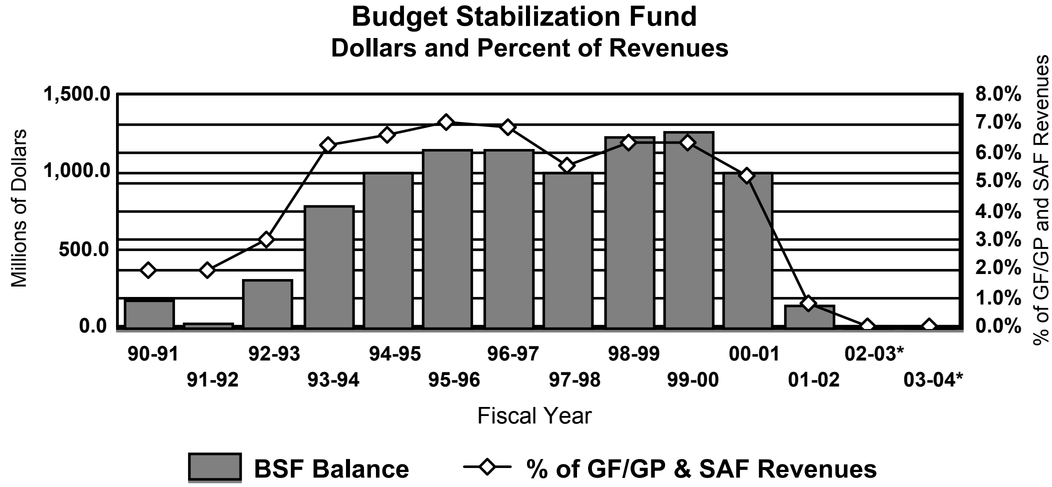
The BSF balance at the end of FY 2001-02 was $145.2 million. Withdrawals consisted of the following: $382.0 million to the SAF ($32.0 million for the Durant settlement), $452.8 million to GF/GP to ensure a zero balance, and $35.0 million to the State Trunkline fund for transportation purposes. In FY 2001-02, no deposits were made into the BSF and interest earnings were $20.8 million.

U ***FY 2002-03 and FY 2003-04***

The BSF balance is estimated to be eliminated at the end of FY 2002-03. Under current law, withdrawals consist of the following: $32.0 million to the SAF for the Durant settlement and $207.0 million to GF/GP. However, the previous year-end balance plus the interest earnings are estimated to be enough to support only a $148.8 million withdrawal. Due to the trigger calculation, as determined by adjusted Michigan personal income growth, no pay-ins are estimated for FY 2002-03 and FY 2003-04.

A complete list of BSF historical data is available from the HFA upon request.

Figure 9



*HFA estimates

Table 6

BUDGET STABILIZATION FUND
(Millions of Dollars)

Fiscal Year	Deposits	Withdrawals	Interest Earned	Balance
1989-90	$0.0	$69.9	$35.8	$385.1
1990-91	0.0	230.0	27.1	182.2
1991-92	0.0	170.1	8.1	20.1
1992-93	282.6	0.0	0.7	303.4
1993-94	460.2	0.0	11.9	775.5
1994-95	260.1	90.4	57.7	1,003.0
1995-96	91.3	0.0	59.2	1,153.6
1996-97	0.0	69.0	67.8	1,152.4
1997-98	0.0	212.0	60.1	1,000.5
1998-99	244.4	73.7	51.2	1,222.5
1999-2000	100.0	132.0	73.9	1,264.4
2000-01	0.0	337.0	66.7	994.2
2001-02	0.0	869.8	20.8	145.2
2002-03*	0.0	148.8	3.6	0.0
2003-04*	0.0	0.0	0.0	0.0

NOTE: Numbers may not add due to rounding ** HFA Estimates*

Compliance with the State Revenue Limit

Article IX, Section 26 of the *Michigan Constitution,* which was approved by the vote of the people in 1978, sets a limit on the amount of revenue collected by the state in any fiscal year. As provided for in the Constitution, the revenue limit is calculated as 9.49% of total state personal income, which is the broadest measure of state economic activity, in the previous full calendar year prior to the fiscal year in which the revenues are measured. The revenue to be considered in the revenue limit includes not only state taxes, but also fees, licenses, and interest earned. Federal aid is not included in the revenue limit calculation.

Implications of Exceeding the State Revenue Limit

Article IX, Section 26, *Constitution of the State of Michigan*, provides that:

> . . .For any fiscal year in the event that Total State Revenues exceed the limit established in this section by 1% or more, the excess revenues shall be refunded pro rata based on the liability reported on the Michigan income tax and single business tax (or its successor tax or taxes) annual returns filed following the close of such fiscal year. If the excess is less than 1%, this excess may be transferred to the State Budget Stabilization Fund. . . .

Furthermore, the state is prohibited from spending any current-year revenue in excess of the limit established in Section 26 by Article IX, Section 28.

The final FY 2000-01 revenue limit calculation indicated that state revenue collections were $2.41 billion below the revenue limit. In addition, for FY 2001-02 through FY 2003-04, state revenues are estimated to be substantially below the revenue limit, by $3.98 billion, $4.06 billion, and $4.28 billion respectively.

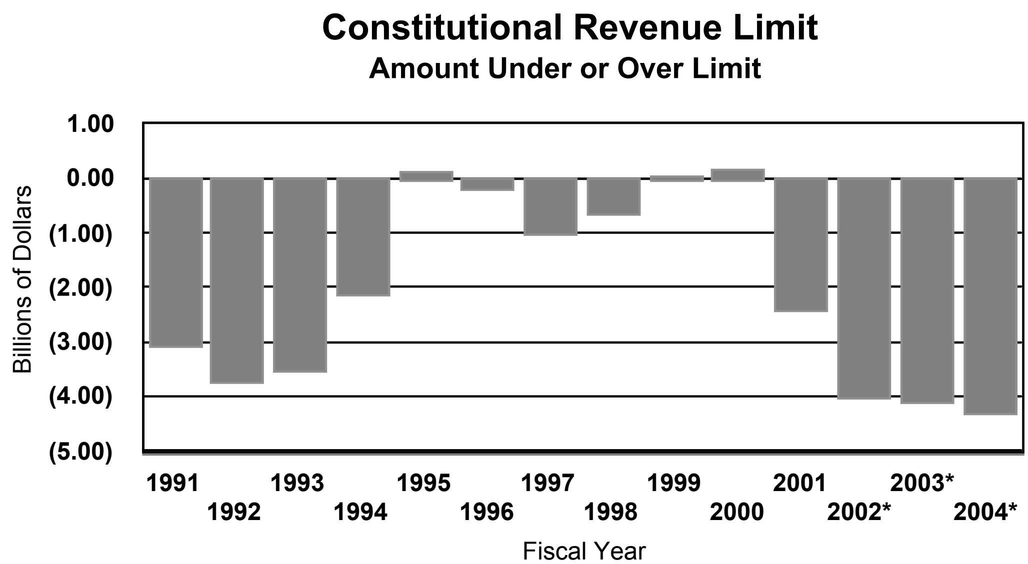
Table 7

COMPLIANCE WITH THE STATE REVENUE LIMIT
(Millions of Dollars)

Revenue Limit Calculations	Final FY 2000-01	FY 2001-02	FY 2002-03	FY 2003-04
Personal Income				
Calendar Year	CY 1999	CY 2000	CY 2001	CY 2002
Amount	$277,296	$289,390	$297,609	$303,509
Multiplied by Limit Ratio	9.49%	9.49%	9.49%	9.49%
State Revenue Limit	**$26,315.4**	**$27,463.1**	**$28,243.1**	**$28,803.0**
Total Revenues Subject to Revenue Limit	23,909.2	23,482.5	24,187.2	24,522.0
Amount (Under) Over State Revenue Limit	**($2,406.2)**	**($3,980.6)**	**($4,055.9)**	**($4,281.0)**

NOTE: Numbers may not add due to rounding.

Figure 10



** HFA Estimate*

Table 8

CONSTITUTIONAL REVENUE LIMIT
(Billions of Dollars)

Fiscal Year	(Under) or Over Limit	Fiscal Year	(Under) or Over Limit
1979-80	($0.53)	1991-92	($3.69)
1980-81	($1.17)	1992-93	($3.48)
1981-82	($1.41)	1993-94	($2.11)
1982-83	($1.32)	1994-95	$0.11
1983-84	($0.24)	1995-96	($0.18)
1984-85	($0.01)	1996-97	($0.98)
1985-86	($0.37)	1997-98	($0.64)
1986-87	($0.84)	1998-99	$0.02
1987-88	($1.35)	1999-2000	$0.16
1988-89	($1.03)	2000-01	($2.41)
1989-90	($1.76)	2001-02*	($3.98)
1990-91	($3.04)	2002-03*	($4.06)
		2003-04*	($4.28)

**HFA Estimates*